/ICS-400075

THE WHITE HOUSE

WASHINGTON

PRESIDENT'S FOREIGN INTELLIGENCE ADVISORY BOARD

Economic Task Force Report

28 January 1983

INTELLIGENCE IMPLICATIONS OF THE INTERNATIONAL BANKING AND FINANCIAL PROBLEM

In PFIAB's experience during the last 10 years, we have faced no problem as complicated and involving so many government agencies as that of the current international financial crisis. The agencies involved in the decision-making apparatus differ in their needs, interests, and backgrounds and training, thus complicating enormously the intelligence requirements which need to be met.

Although this report addresses the intelligence implications which flow from existing and impending international bank and financial problems, the focus of the observations which follow is almost entirely on the particular problems deriving from the inability of the Less Developed Countries (LDCs) to meet their debt obligations. Certain Soviet Bloc countries are also experiencing economic difficulties. In some measure, the findings and recommendations in this report regarding LDCs are relevant to the countries of Eastern Europe. Yet there are significant differences which lead us to conclude that our observations might be helpful if we restrict them to a set of nations which differ in one vital respect--their problems are not further complicated by an institutional relationship with the Soviet Union.

The Treasury Department, the Federal Reserve System, the Comptroller of the Currency, and the agencies involved in assuring the safety of U.S. banks view the debt repayment problems as overwhelmingly financial and banking in nature.

The Commerce Department and Council of Economic Advisors (CEA) have major concern with the economic impact of the repayment problems. The Commerce Department, in particular, is concerned with the impact on the U.S. economy of reduced imports by debtor nations, the rising threat of a protectionist contagion, and the serious impediments these may present to the recovery and growth of the U.S. economy.

The State Department and the Assistant to the President for National Security Affairs, while concerned with the facets of the problem already mentioned, have another level of interest. Debtor nations may suffer political consequences from their financial and trade difficulties as well as from International Monetary Fund (IMF)-imposed austerity measures. Reduced imports by particular debtor nations, significant contraction in government spending, and imposed economic austerity are measures which threaten the stability of the very nations already enfeebled by the economic events of the last several years. Intelligence must be alert to all such disruptive developments and their consequences. To satisfy these U.S. policy needs, the Intelligence

Classified by Multiple Sources

Community must be able to provide virtually continuous assessment of risks that flow from measures intended to improve the liquidity of the debtor nations. Unintended consequences of ostensibly helpful measures may nudge them from the financial frying pan into the political fire.

There is virtual agreement among the government agencies involved that the one major remedy to the difficulties encountered by the major LDC debtors is a resumption of significant economic growth by the U.S. and the other major industrial nations. This increases the need for accurate, current economic projections and assessments in order to make those judgments as useful to policy formation as is possible.

ANALYSIS OF THE CURRENT STATE OF INTELLIGENCE DIRECTED TO THE LDC DEBT PROBLEMS, WITH RECOMMENDATIONS FOR IMPROVEMENT

1. The possibility of international crisis places a premium on speed and accuracy of intelligence acquisition. It also requires timely absorption of that intelligence by the policy-making entities of government.

The tasking and monitoring of needed information and intelligence involves a very wide spectrum of government activity. These not only make coordination absolutely essential, but also place a high premium on the continuous joint participation of the agencies involved.

These imperatives warrant the establishment of an active coordinating mechanism that will:

a. be capable of centralizing the acquisition of financial intelligence and making it available to those who will have to act on it; and

b. be able to coordinate the active responses which particular contingencies will require.

We believe the SIG-IEP, which is chaired by the Secretary of the Treasury, provides the appropriate intergovernmental framework for this purpose. However, no Senior Interdepartmental Group, including SIG-IEP, is designed to assure continuous and timely attention.

We therefore recommend that a small, full-time staff, representative of the responsibilities of the various key agencies, be established to serve under the Secretary of SIG-IEP (who is also a key economic specialist on the NSC staff) for the duration of the crisis period so that they may carry that continuing responsibility needed to serve the Chairman and the members of the Senior Interdepartmental Group.

2. An excellent cooperative relationship exists among the government elements dealing with the financial aspects of the LDC debt. Inadequacies remain:

a. essential data involving financial transactions, especially the scope and direction of electronic bank flows, are incomplete; and

b. financial data are often months old.

A Treasury Department study states the problem in stark terms: "There is room for massive improvement; we do not know who owes what to whom."

In order to identify problems as they develop and before they reach crisis proportions, we recommend that data on total financial lending to specific countries must be made available in a concise format and with minimum time delay (reporting currently lags up to six months).

3. Among the many sources of information, one of the most important is the Federal Reserve System. While taking into account the need to preserve the Fed's independence and integrity, we recommend that a means be devised that will allow other members of the coordinating mechanism to have access to the unique and valuable information acquired by the Fed.

We further recommend that a fully informed Fed staff member be a regular participant in the functioning of the SIG-IEP or any other management mechanism which may be established.

4. In major U.S. missions overseas, much is lost because of lack of cooperation between the Financial Attache and the CIA economic specialist assigned to those embassies. We urge that the Secretary of the Treasury and the Director of Central Intelligence undertake to improve this relationship in a manner that will enrich intelligence and not handicap the Financial Attache.

5. Although each major potential debt default may be successfully averted, each success may have serious consequences to the U.S. and other industrial economies. We urge that those often unintended consequences be given adequate attention.

6. The CEA, a key participant in all areas of economic policymaking, is not completely aware of and does not have full access to the complete information resources available within the Intelligence Community. This gap is especially pronounced in the international economic area where much critical information is obtainable only from intelligence sources.

CEA must strengthen its relationship with the Intelligence Community. We recommend that a CEA staff member, with full clearances and access, should be designated as liaison to the Intelligence Community and serve as a conduit for all available intelligence material which relates to the Council's area of responsibility.

7. The Treasury Department, the Federal Reserve System, and a community of agencies are concerned with the integrity of U.S. banking and with the need to maintain confidence in U.S. banks. The necessity to reinforce banking confidence must not, however, be permitted to skew the intelligence information or analysis, or judgments which emanate from these agencies.

THE INTELLIGENCE CONTRIBUTION OF THE CIA AND RECOMMENDATIONS FOR THE ENHANCEMENT OF THAT CONTRIBUTION

The major reorganization of the CIA analytic process initiated by the

DCI more than a year ago is especially well-suited to meet the analytic needs generated by the present "crisis." In addition, the creation of a new office in the CIA, the Office of Global Issues with its Third World Issues Branch, adds further to the structural capability needed.

1. The CIA does not presently have sufficient staff members with backgrounds adequate to the requirements for sophisticated financial analysis. Severe, perhaps insoluble difficulties exist in recruiting the kind of expert financial personnel required to meet the CIA's needs during this period. Although we are encouraged by the extent of the CIA's effort to benefit from knowledge uniquely held by the private sector, still more effort is needed.

The CIA should make every effort to recruit additional competent staff. In addition, in order to meet an overwhelming need to gain access to the informed judgments available in the private community, we recommend that, where possible, consulting arrangements should be made. Where not possible, other cooperating relationships must be cultivated.

2. The Directorate of Intelligence has prepared a well-designed and ambitious schedule of studies for completion by the end of the year. We do not recommend an arbitrary speeding up of the process. In our opinion, the completion of able analysis in the fields projected within the time period specified will itself be a significant accomplishment. A number of those issues, however, have the potential to become major problems in the short term.

We recommend that CIA should closely monitor developments in the areas for which analysis is incomplete in order to be able to provide abrupt assessment even as the schedule of work progresses.

3. One of the major vulnerabilities of the intelligence process in dealing with the financial issues is that speed and accuracy are required to detect and react to specific indications of economic and political trouble.

We recommend that the Intelligence Community devise a set of indications and warning criteria for economic and political issues which will alert analysts and policymakers to developing or potential problems in particular countries. To the extent that it is possible, we believe such a warning mechanism should identify related and escalating contingencies in each of the problem areas: international finance, banking, trade, economic, and political.

4. We had previously suggested that the political consequences which may flow from the present situation may be potentially at least as dangerous as the financial aspects of the LDC problems. Much of that intelligence and virtually all of the useful analysis of it will depend on staff located in Washington. Some, however, and by definition the most sensitive part, rest on the political capability of the CIA within the problem countries. A recent PFIAB study reached the conclusion that that capability in Mexico was deficient. That study was conducted prior to the maturing of the debt problem in Mexico.

We recommend that the political intelligence capability in each of the problem geographic areas be reviewed to assure that needed information will be forthcoming in an adequate and timely fashion, especially since those staffs now carry a more demanding intelligence role than has previously been the case.

5. Difficulties within the particular debtor nations are the object of analytic concern. We believe, however, that largely neglected is the impact of debtor country difficulty upon other less-developed countries with which that debtor country maintains political or economic relations. We urge that these and other secondary consequences engage the attention of the Community.

6. Two of the key government officials involved in the international financial area have indicated to us the importance of timely forewarning of the plans and intentions of foreign governments and financial ministries, as well as their reactions to major economic events.

Relevant elements of the Intelligence Community must obtain complete, prompt, and authoritative knowledge of strategies concerning the management of debt problems that are being contemplated or adopted by officials of the major debt countries, acting alone or in concert.

We close with three observations. First, we would like to commend the Commerce Department's International Trade Administration for their active and thorough response to this challenging issue. They have taken the lead in attempting to analyze and address some of the more difficult aspects of this problem. Secondly, DCI Casey's professional and governmental activities over the years have obviously played a salutary role in redirecting the work of the Community to more adequately meet the new critical economic intelligence responsibilities. Finally, we regret that the public cannot see the nature, scope, and depth of the intelligence response to these problems. Within weeks of the first evidence of the LDC debt problem, the Intelligence Community was producing broad spectrum intelligence and analysis of exceedingly high quality. In our opinion, a more widespread awareness would change the distorted view of the function of intelligence and persuade the skeptical of its essentiality.